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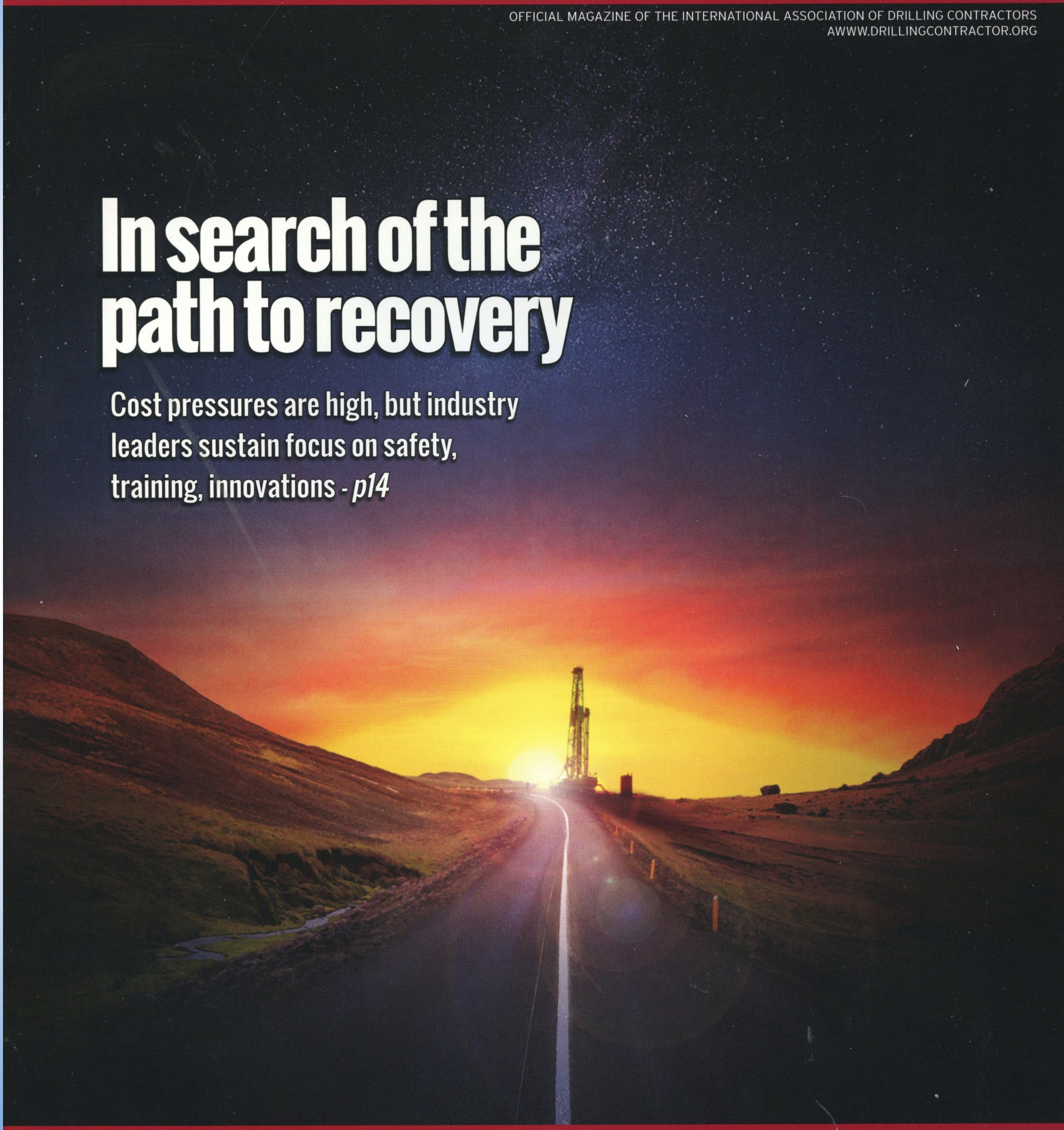


In search of the path to recovery

Cost pressures are high, but industry leaders sustain focus on safety, training, innovations - *p14*

AFRICA'S POTENTIAL ON HOLD

Contractors face lower dayrates, rig stackings as operators trim CAPEX down further - *p64*

TOM BURKE IS 2016 IADC CHAIRMAN

Association to continue engagement with public, regulators, encourages more member participation - *p78*

Times are tough in unbalanced market, but industry should recognize, prepare for increasing volatility as the new norm

Downturn also provides chance to retire mechanical rigs, but continuing demand shows SCR rigs still have place in the market

By Linda Hsieh, Managing Editor, and Kelli Ainsworth, Editorial Coordinator

TRENT LATSHAW IS PRESIDENT OF **Latshaw Drilling and Exploration Company.** Mr Latshaw is also a member of the IADC Executive Committee.

What do you consider to be the biggest challenges that drilling contractors face at the moment?

The biggest challenge is simply rig rates. During downturns like this, just trying to stay alive and make it to the other side of this cycle is the No. 1 concern. Aging rig equipment may be an issue with some companies but not with us. About 99% of our rigs have been built new since 2006.

Do you think the fundamentals of the industry are still good?

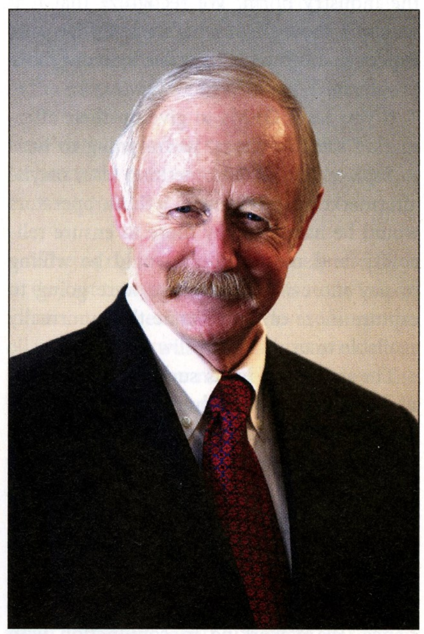
Demand is a pretty simple concept. It increased 1.8 million barrels last year and is estimated to be increasing 1.2 million barrels this year, and after that will increase by an estimated 1 million barrels a year. That's about 1% growth per year. Excess production now is about 1.5 million to 2 million barrels. In the most simplistic form, you can see it's only going to take two years to soak up that excess production. That doesn't even include all the other moving parts of supply, the projects put on hold and the decline rates.

Do you think the pressure to cut costs will impact either rig equipment reliability or downtime over the coming year?

It can. When companies don't have money to reinvest back into their equipment, they cannibalize stacked equipment. If you run out of equipment to cannibalize and the rates still are not there to give you a decent return to reinvest back into the maintenance and upkeep of your rigs, then that's where companies get to the point where they stack equipment and either sell it at auction or wait for the market to improve.

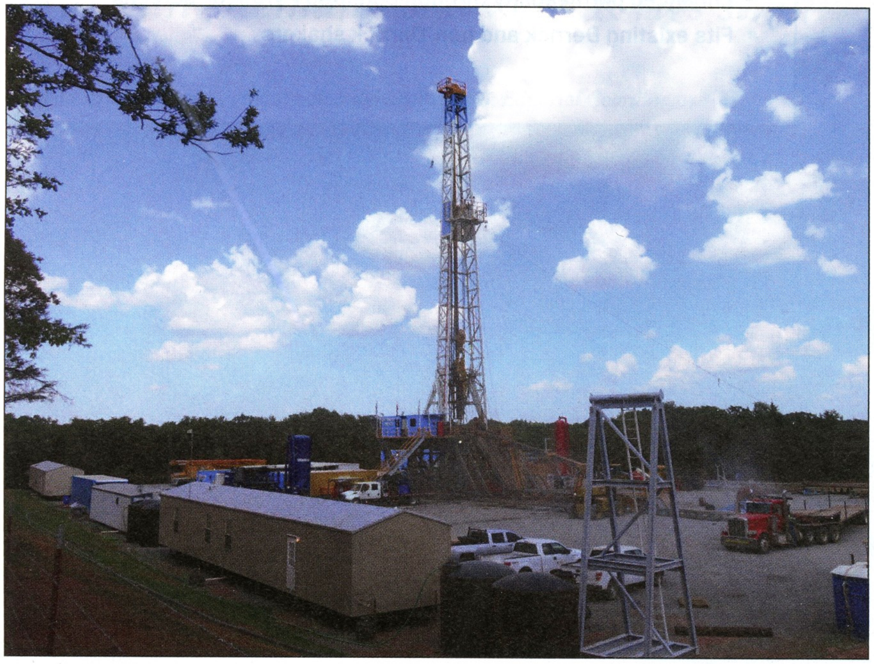
Some companies work at their cash breakeven operating costs, which means they get a dayrate that covers their labor, insurance and maybe some maintenance. That's all well and good until you blow up a mud pump or your top drive goes down, or you have a bad accident on a rig. Even though a contractor may be breaking even on his operating costs, if he has any breakdown on equipment or a major accident, then there are brackets around those numbers now. It's not worth the risk to do that. Eventually a dayrate gets to the point where I'd personally just decide to stack the rig.

You mentioned that you've built quite a few new rigs since 2006. What conditions would you need to see in the market in order to start ordering newbuilds again?



Trent Latshaw, President, Latshaw Drilling and Exploration Company

The only way we would do any newbuilds, even in the future, is under three-year con-



TOP: Latshaw Rig 8 drills in West Texas in September 2015. The 2,000-hp SCR rig is working for Element Petroleum in Howard County. Despite the industry perception that AC rigs are generally better performers than SCR rigs, Latshaw Drilling has found that there is still a place for SCR rigs. Latshaw Drilling has been able to put seven SCR rigs back to work since May 2015.

BOTTOM: Latshaw Rig 33 drills in Lincoln County, Oklahoma. The 1,000-hp rig includes a skidding package and is one of the company's 10 AC rigs. With most of Latshaw Drilling's rigs having been built new since 2006, aging equipment is much less of an issue for the company than the decline in rig rates.

tracts. It takes about $27,000 a day to justify building a $20 million-plus rig. Even with a three-year contract, that doesn't pay it out. It gets you 75% to 80% there.

What are your considerations when looking at whether to stack a rig versus retiring it?

If I had a bunch of older mechanical rigs, I'd ask if it makes sense to hold onto them. The only reason it would make sense is if I think that rig has some kind of future in the market. Typically those rigs would be drilling shallow vertical wells. They generally have smaller mud pumps, and they don't have top drives or walking systems. They're not going to be drilling horizontal wells. Then I have to ask how much market is there going to be for vertical wells in the future. What kind of shape is the rig in? Can I upgrade it and make it a viable rig for horizontal drilling? When you start looking at the dollar amount it would take to do that, sometimes you realize you might as well buy a new rig.

Do you think more rig retirements are needed to rebalance the market?

The rigs that are being cut up or retired are the mechanical rigs, and that is not going to do anything to help the US fleet. Every mechanical rig in the fleet could disappear tomorrow, and it really wouldn't improve the situation. When oil prices and demand go up and rigs go back to work, at that time it would help not to have an overhang of mechanical rigs. However, if the rigs are going back to horizontal drilling jobs, it's still a moot point.

From your perspective, how is the market impacting operators' preferences for newer but more expensive rigs over older but less expensive ones?

Some operators want state-of-the-art AC rigs over SCR. However, our SCR rigs have drilled for customers in the same area where another company has an AC rig. We can drill just as fast as they can, and we can actually trip faster than they can.

When people say SCRs are going to be obsolete and AC is the thing of the future, I disagree. Back in May 2015, we bottomed at 11 rigs working, which is 28% utilization. Since that time, we have put nine rigs back to work. One of those nine is a new AC rig, but of the other eight, only one was an AC rig. The other seven were SCR rigs. We're actually getting more money for our SCR rigs that we have put back to work than we're getting for some of our AC rigs right now. To me, that proves SCR rigs still have a place out there. Not everybody's saying they want an AC rig.

The industry has been working for many years to recruit and train a new generation of employees. Now it's necessary to lay off a lot of these people. How can we ensure we're not just erasing the work we've done in the last decade?

We can't. Just like operators will cherry pick their rig fleet and keep the best of the best rigs, contractors will do the same thing with their people. As you lay people off, you have to bump other people. You have to bump drilling superintendents back to rig manager, and rig managers to drillers. When you start bumping a bunch of these drillers back to working derricks or floors or motors, it might have been years since they've been out there working on the floors and pulling slips. The big concern then becomes safety. Are we going to have a bunch of pulled backs or smashed fingers because it's been so long since they've worked floors? To our surprise, it has not been an issue.

People typically aren't an issue during a downturn. When we start cranking back up again, they will be. I heard somebody make the statement that we've got great people now and good efficiencies, but when we start ramping back up, all that gets diluted again. That will be an issue that we'll have to face in the future.

Do you think the downturn has caused the industry to lose its focus on safety at all?

More than anything, we've seen the opposite. People become more safety conscious. We make sure our people understand that, especially in a market like this, operators truly look at your safety record. If you're above a certain TRIR, some companies won't even talk to you. We impress upon the guys that safety is something you focus on for the right reasons, but then you also do it for the business and economic reasons. If we can't get a good safety record, we're going to have our rigs stacked.

In a presentation you gave at the 2015 IADC Annual General Meeting, you advised the young people in the industry to expect volatility. Going forward, do you expect to see more ups and downs, perhaps at a faster rate than what the industry has seen before?

Latshaw Rig 14 drills in West Texas in September 2015. The rig is equipped with 1,600-hp mud pumps and a walking system. Going forward, the company does not foresee building any new rigs unless there is at least a firm three-year contract.

In the past couple of cycles, some people have said what we're seeing is higher lows and higher highs, and of shorter duration. But no two booms or busts are for the same reasons. Last time it wasn't a supply and demand issue; it was **Lehman Brothers**. When they filed Chapter 11, the financial world went into gridlock. Everybody panicked, and the rig count went down. Then everyone realized the financial system was not melting down, and people started putting rigs back to work.

Unfortunately, this one's different. In the last boom, people were saying this boom is different; it's demand driven. This boom was different, but it meant the next bust would be for different reasons than the previous bust. They're never the same. You might say this one was just like in 1986, and that may be correct, but very rarely do you ever get subsequent booms and busts all for the same reason. If you did, then it would be a lot easier to predict them and anticipate them coming.

What else would you say to the young people facing their first downturn?

This is not life or death. I don't mean to minimize it. It's stressful, especially for someone who's either worried about losing their job or just lost it. However, you still have friends and family and, hopefully, you're healthy.

I think things happen for a reason and usually for the best, even though you don't see it at the time. Sometimes it takes years to look back and realize that getting laid off, or run off, from that job was the best thing that ever happened to you. Because that happened, you went in a different direction, and look at all these opportunities that presented themselves because of that.

I look at failures as a learning experience. What did I learn from that? What will I do differently because of it? I'm going to look forward with anticipation to other opportunities that are going to present themselves down the road, even though that one didn't work out. Babe Ruth was the homerun king and the strikeout king. You can't hit a homerun unless you step up to the plate and swing for the fences. DC

SCAN ME to read Trent Latshaw's 13 points for surviving a downturn.

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